



THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

March 24, 1983

MEMORANDUM TO: Harry Rowan

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FROM : R. T. McNamar *R.T.M.*
SUBJECT : Impacts of Oil Price Declines -- Phase II

As you know, following the Quadriad's breakfast meeting on Tuesday, we agreed to proceed with the Phase II Analytical and Policy Issues. Attached are final lists of these issues and the assignments to various agencies, based on our discussions Tuesday. Below is a list of issues for which you have lead responsibility. We will leave it up to you as leader to contact the other parties interested in the issues (listed in the attachment) and to convene the group. Also, as group leader, feel free to adjust the definition of the issues if they are not properly stated.

By our next full group meeting -- Tuesday, April 5, 4:00 p.m. at Treasury -- we hope that the groups would have met, agreed on the analysis to be done and be well underway on the work. With luck, some of the analyses will even be completed.

We appreciate all the efforts you are making. I will be away next week, but if there are any questions, please call Kevin Coyne at 566-5500.

Issues for which you have lead responsibility:

Analytical Issues: I(b), I(c), I(d), III(c)

Policy Issues: 6

Attachments

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SUMMARY OF ANALYTICAL ISSUES
TO BE ADDRESSED IN PHASE II

Responsibility

I. FUTURE PRICES OF OIL

(a) Current forecasts

- What do private forecasters currently predict for the long-term future price of oil?

Treasury (lead), T-2

(b) Production levels

- What is the likely effect of various oil prices on the levels of production by each country?

CIA (lead), State,
Treasury, DOE, OMB

- What factors do individual oil exporting countries face that force them to increase or decrease production from their preferred levels?

e.g. -- Saudi natural gas supply contracts
-- Anticipated revenue needs
-- Physical constraints in North Sea, coupled with British law requiring purchase and resale of 51 percent of North Sea production

(c) Demand/consumption

- What assumptions should be made about the response of demand to large declines in oil prices (e.g. to \$20 or \$15)? How does this demand response vary by country? (This analysis should be approached by an analysis of demand for oil in each major sector of the economy.)

CIA, Treasury (joint lead), T-2, State, DOE

- What are the appropriate ranges of elasticities for use in analysis? Are elasticities the same for price declines as they are for price increases?

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Responsibility

(d) Inventories/Speculation

-- What role does the holding of oil inventories for speculation purposes play in influencing the price of oil?

CIA, DOE (joint lead),
T-2, State

-- Is this practice widespread and/or increasing?

-- What is the current inventory situation in both producing and consuming nations?

(e) Integration

-- Based on the above, what appears to be a reasonable range of expectations for the long-term prices of oil?

DOE (lead), T-2,
CIA, State

-- How does the price outlook change if demand for oil increases due to (an arbitrary assumption of) real free world economic growth of 5 percent per year?

DOE (lead), T-2,
State, CIA

II. IMPACTS ON THE UNITED STATES

(a) Macro-economic impacts

-- What are the implications, if any, of lower oil prices for monetary policy?

Treasury (lead),
Federal Reserve,
OMB, CEA

-- What other commodity prices tend to move with or against the price of oil? What impacts would declines in those prices cause?

Commerce (lead), T-2

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Responsibility

(b) State and local economies

- What effect will falling oil prices have on the economies and state government budgets of individual states (e.g. Texas, Alaska)?
- What initiatives are various state governments taking to raise oil and/or gasoline taxes in anticipation of lower oil prices?

Treasury

(c) Federal budget

- What causes the differences between Task Force and CBO estimates of changes in the federal deficit as a result of declining oil prices?

OMB (lead), T-2

III. INTERNATIONAL IMPACTS

(a) Exchange rates

- How are exchange rates likely to be affected by declines in oil prices (especially the Yen/dollar relationship and the British Pound/dollar relationship)?

Treasury (lead), CEA

(b) LDC debts/IMF

- How do lower oil prices, lower inflation, higher world economic activity levels and lower interest rates interact to affect the ability of LDCs to repay international debts?
- What impacts are these factors likely to have on demands for IMF loans?

NSDD (Treasury-OASIA lead)

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Responsibility

- Is there any likelihood of oil price declines directly or indirectly causing "drastic political consequences" in oil exporting LDCs (e.g. civil upheaval, fall of governments, repudiation of foreign debt)?
- State (lead), CIA, Commerce (ITA)
- (c) How do oil price declines affect the Soviet Union's ability to pay for foreign purchases?
- CIA
- IV. OTHER ISSUES
- (a) What impacts might an oil import fee and/or gasoline tax have on the macro-economic outlook if all revenues were devoted to reducing the federal deficit?
- Treasury (lead), others
- How does this change if the tax is decremented to flow through to the public over time?
- (b) Could an oil import fee and/or gasoline taxes influence the world price of oil, and/or the competitiveness of U.S. industry?
- State, Treasury (joint lead), Commerce, DOE
- If the U.S. alone imposes such a tax?
- If our allies (e.g. G-7, OECD) impose such a tax, but the U.S. does not? (In addition, what taxes are they considering?)
- If the U.S. and its allies impose such a tax?
- (c) At what point (price of oil) do the above effects begin to move out of proportion (i.e. non-linearly) with further changes in oil prices?
- (Implicit in issues above)

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SUMMARY OF PHASE II POLICY ISSUES

<u>Issue</u>	<u>Responsibility</u>
1. ● How are falling oil prices likely to affect the need for bail-outs? (i) Oil industry/OPEC borrowings from commercial Banks? (ii) IMF/World Bank/Development Banks loan requests? (iii) Direct approaches to the U.S. Government (e.g. Mexico, Son-of-Chrysler)?	CCEA Troubled Industries group (OMB lead) for domestic SIG-IEP for international (Treasury-OASIA lead)
2. ● Ignoring the issue of whether the U.S. would want to take such actions, are there market related actions that the United States could take to affect the price and/or pattern of supply of world oil? For example: (i) Sale of Alaskan crude to Japan (ii) Long-term contracts with individual nations (iii) Coordinated oil import fees by major industrial countries	SIG-IEP (Treasury-OASIA lead)
3. ● How should the Administration's strategy for the Strategic Petroleum Reserve be affected by declining oil prices? In particular, what should the SPR purchasing strategy be in the short-term (since purchases affect the oil price outlook)?	Cabinet Council on Natural Resources

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<u>Issue</u>	<u>Responsibility</u>
4. • How might a general decline in oil prices affect specific Administration energy policies? (i) Natural gas deregulation (ii) Oil exploration leases (iii) Synfuels	Cabinet Council on Natural Resources
5. • How do falling world oil prices affect the strategic interests of the United States? (i) Is it likely to cause disruption in the Middle East? (ii) What actions might the Soviet Union take in the light of declining ability to purchase foreign grain? (iii) How does it affect the long-term energy security of the United States? (iv) How might it affect overall East/West relations?	NSC (lead), State, CIA, OMB
6. • What impacts/disruptions are likely to occur if a precipitous price decline were followed immediately by an explosive price increase? (a) Domestic (b) International	Treasury (lead), T-2 CIA (lead), State

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<u>Issue</u>	<u>Responsibility</u>
7. ● What are the policy options with respect to the impact of decline in oil prices on Defense Department budget (e.g. defense deflator, etc.)	OMB (lead), T-2
8. ● How should the individual country impacts affect overall East/West relations (especially those of Western Europe with the Soviet Union)?	NSC (lead), State
9. ● How do oil price declines affect potential alternate sources of energy for Europe? (e.g. -- -- Soviet natural gas pipeline -- Development of the Norwegian Troll field	NSC (lead), State, CIA, OMB
10. ● What actions should the U.S. be willing to take unilaterally, and what actions should we undertake only in concert with other G-7 or OECD members?	SIG-IEP (Treasury-OASIA lead)
11. ● What impact does falling oil prices have on bilateral and multilateral aid issues?	SIG-IEP (Treasury-OASIA lead)